TRAVEL, HOSPITALITY & LEISURE

Quick Bites – Business Growth Strategy for Quick Service Restaurants (QSRs)

Part 1: Maintaining Momentum and Maximizing Profit Margins

A&M's Travel, Hospitality & Leisure practice presents Quick Bites, a series on how QSRs can profitably deliver outstanding experiences to customers as they navigate the current market.

How Can QSRs Navigate the Challenging and Evolving Industry Landscape?

The QSR industry is currently experiencing a remarkable surge in growth, characterized by significant consolidation and acquisition activities. The top 50 QSR brands in the United States are actively expanding their reach, endeavoring to establish closer connections with their target customer base through innovative loyalty programs and personalized promotional offerings. Between 2021 and 2022, these leading QSRs achieved an impressive **average sales growth rate of 4.6 percent along with a notable 2.9 percent increase in their store counts**[1]. While the industry basks in this positive momentum, stakeholders, including corporate entities and private equity firms that predominantly own QSR brands, are diligently exploring strategies to sustain this growth trajectory and enhance overall profitability.

From the consumer's vantage point, a prominent concern on the horizon is the persistent issue of inflation. Many **consumers have shifted their dining preferences from higher-cost full-service restaurants to QSRs;** however, there is a looming risk that they may curtail their spending on dining out further. The delectable offerings of burgers, pizzas and fries, though tempting, have seen a steady rise in prices since the onset of the COVID-19 pandemic. Initially, this trend began with delivery services introducing their own pricing structures, and subsequently, it was exacerbated by supply chain disruptions and inflationary pressures. The period from July 2022 to July 2023 witnessed a significant **7.1 percent increase in the Consumer Price Index**[2] **for food away from home.**

In response to the mounting cost pressures and to protect their profitability, most QSRs resorted to **price increases**[3] **ranging from five percent to ten percent in 2022.** However, this move also resulted in a **concerning four percent to six percent reduction in customer traffic**[3] during that period. **QSRs are now grappling with the challenge of striking a delicate balance in this dynamic market environment.** On one hand, they seek to enhance their engagement with customers, and on the other hand, they must implement strategies for operational efficiency. **This duality poses a strategic imperative for QSRs, as they navigate the intricacies of an evolving landscape while endeavoring to secure their bottom lines in the face of mounting pressures and shifting consumer behaviors.**

References:

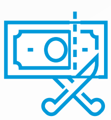
1. QSR Magazine, Aug-23 and Aug-22 Issues
2. The Consumer Price Index for Food Away from Home https://www.bls.gov/news.release/cpi.t01.htm
3. A&M analysis over public QSR brand dataset

Overview of QSR Companies in the United States

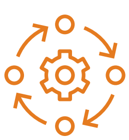
	1	2	3
Operating Model	**Highly Franchised** >80% Franchised Units	**Intermediately Franchised** 20% to 80% Franchised Units	**Highly Company Operated** ≤ 20% Franchised Units
Strategic Focus	**Growing number of franchises and improving traffic in stores.**	**Growing by acquisition and improving store traffic.**	**Growing by store development and improving store traffic.**
G&A[4] as % of Revenue	**As low as 1.5%**	**As low as 3.8%**	**As low as 5.1%**

Four Steps QSRs Can Take to Sustain Profitable Growth

Although the QSR **operation varies significantly across different operating models, market and geography**, there are best practices that QSR brands can take to prepare for a profitable future and enhance customer experience.



1. **Optimizing Cost Management –** As QSR brands expand their footprint and operations, their cost structures invariably expand as well, **potentially leading to inefficiencies creeping into their business models.** Drawing insights from **A&M's analysis[4] of 16 publicly listed QSR brands, it becomes evident that several brands exhibit higher-than-benchmark general and administrative (G&A) expenditure.** While it is acknowledged that each brand possesses unique growth requirements and trajectories, certain cost categories such as **corporate G&A, food, procurement, labor, facilities, advertising and marketing offer specific opportunities for cost optimization.** Harnessing these opportunities can have a profound impact on enhancing the earnings before interest, taxes, depreciation and amortization (EBITDA), thereby bolstering the financial health of the QSR brand.



2. **Streamlining Operational Complexity –** In tandem with identifying cost-saving avenues, QSR brands can further **streamline their operations, particularly in areas such as procurement, store development, franchise operations and menu planning and management.** Within the franchise model, the franchisor's overarching objective is to boost same-store sales and attract new franchisees. **Innovative approaches can be employed, such as co-branded outlets** that rationalize stock keeping units (SKUs), reimagine kitchen design, layout and processes, rationalize technology, signage, staffing and training, **all of which culminate in heightened returns for both franchisees and franchisors, while simultaneously offering an expanded array of choices to customers.**

3. **Pursuing Strategic Expansion –** While improving operational efficiency, brands cannot give up their growth aspirations. The unprecedented challenges posed by the pandemic **underscored the critical importance of scale in safeguarding the bottom line for QSR brands.** Expansion through acquisition has emerged as a viable strategy, with many prominent brands actively seeking to acquire smaller, proven names in a bid to diversify their portfolios. To maximize the benefits of such endeavors, **QSR brands must refine their mergers and acquisitions approach to meticulously screen potential targets** with immediate franchising potential. This approach, coupled with their stature as large franchisors, affords brands greater **control over third-party costs and supply chains,** thereby fortifying their operational resilience and competitive advantage in an ever-evolving industry landscape. Growing by franchise is the fastest and most cost-efficient way to get closer to customers and improve revenue. One major chain is **increasing royalty fees[5] by 25 percent** to improve their earnings and margins.

References:

4. Based on Alvarez and Marsal's General & Administrative (G&A) expense analysis of 16 publicly listed QSR companies in the US. Analysis referred Companies' 10-K filings, Companies' annual reports when separate from 10-K, and Companies' press statements to report financial results.

5 . https://www.restaurantbusinessonline.com/financing/mcdonalds-plans-increase-its-us-royalty-fees-25

4. **Elevating the Customer Experience –** Finally, customer-centricity is the most important aspect of the QSR business model. In the fiercely competitive QSR industry, **owning and nurturing customer relationships emerges as a strategic imperative.** The ability to recognize and engage customers across various channels and tailor interactions and messaging accordingly has become paramount. The advent of third-party delivery platforms has introduced a challenge in this regard, as QSR brands grapple with the task of identifying and connecting with customers who opt for these external channels. Therefore, **prioritizing digital and loyalty transformations becomes essential to incentivize customers to shift from third-party platforms to direct channels.** Often, multi-brand corporations grapple with siloed loyalty programs that hinder customer retention and rewards. Considering increasing price pressures, customers seek direct channels that offer superior value for their dining experience, underscoring the importance of this customer-centric shift.

Next Step: Define Your Path Forward

The QSR industry faces critical decisions ahead, and a lack of action could yield unfavorable outcomes. Neglecting to address the QSR industry's evolving dynamics may result in missed opportunities and reduced competitiveness.

Our focus at Alvarez & Marsal is to bring an operator mindset and a bias towards action to drive business transformation with restructuring speed. By executing these strategies effectively, QSR brands can not only weather current challenges but also position themselves to thrive in a rapidly changing market, ensuring a profitable and satisfying dining experience for their customers.

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